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C O N F I D E N T I A L SECTION 01 OF 03 TBILISI 000387

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TAGS: [ENRG](#) [EPET](#) [PGOV](#) [PREL](#) [GG](#)  
SUBJECT: GEORGIA MINISTER OF ENERGY ON BTC PIPELINE  
EXPANSION, GEORGIA'S GAS NEEDS

Classified By: Amb. John F. Tefft, reason 1.4(b) and (d).

11. (C) Summary: The Ambassador met with Georgian Minister of Energy Aleko Khetaguri on February 27. Khetaguri told the Ambassador that Georgia is not willing to approve expansion of the Baku Tbilisi Ceyhan (BTC) pipeline until it receives an explanation of BP's plans for re-opening the Baku-Supsa oil pipeline, which has been closed down for repairs for several months. Khetaguri said that the government has dropped linkage between BTC expansion and its demand for flexibility by BP and AIOC in providing gas to Azerbaijan from the ACG oil field -- flexibility that will free up Azeri gas for Georgia's potential use. Overall, Khetaguri knows that larger oil transit volumes are in its interest, and he supports an active export route via ship or pipeline across the Black Sea to the Odessa-Brody pipeline, that would handle increased shipments via the Caucasus from Kazakhstan. To obtain gas for the future, Georgia has proposed a five-year contract with Azerbaijan for gas at a price of USD 150-160, calculated on the cost Azerbaijan must pay to burn mazout in place of gas supplied to Georgia. After 2009, when more gas is on line in Azerbaijan, Georgia would pay a commercial price. Khetaguri downplayed the importance of Georgian plans to sell Georgian Railways. He said that the government is seeking expressions of interest in order to figure out a value for the system, and would at first sell no more than 10 percent of it. The Government is pursuing plans to further increase production of hydropower for domestic use and export to its neighbors. End Summary.

LINKING BTC EXPANSION TO CLARITY ON  
BAKU-SUPSA, NOT GAS FROM ACG  
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12. (C) Khetaguri noted that Georgia has just survived the coldest winter on record, with temperatures of minus 14-15 for two weeks in a row at one point. The country suffered no noticeable shortages of natural gas over the period. However, Khetaguri said he finds the situation with regard to oil better than that for gas. Khetaguri is well aware of BP's and AIOC's desire to increase the capacity of the Baku Tbilisi Ceyhan (BTC) pipeline from 1 million bbl/day to 1.2 million, and then to 1.6 million with infrastructure upgrades. Khetaguri said the BP is telling him that the Baku-Supsa pipeline, which has been idle for more than a year, will start operations again in April, though he has his doubts that target will be met. He is also hearing that BP wants to transfer operation of the Baku-Supsa pipeline to the Azeris, as BP has already done on the Northern Route pipeline through Russia.

13. (C) Khetaguri noted that Baku-Supsa carries 175,000

barrels of oil per day when operating. He expressed concern that the 200,000 bbl/day capacity to be added to BTC will be sufficient for BP to redirect all the oil that flows through Baku-Supsa to the BTC. There will, of course, be Kazakh oil available for both routes, if Azerbaijan's SOCOR allows it, he said. SOCOR already is preparing the Kulevi oil terminal in Georgia on the Black Sea for opening, and the only way there is by rail. Khetaguri worries that if SOCOR takes over Baku Supsa, it will have a near-complete monopoly on oil transit through Georgia. The only exception will be the Batumi Oil Terminal, which the Danish company GreenOak has sold to Kazakhstan. The Azeris are already creating problems for the Kazakhs at the port in Baku and on the railroad in Azerbaijan.

14. (C) Despite these concerns, Khetaguri looked forward to increasing shipments of oil via Georgia, and is supportive of the building of an oil pipeline across the Black Sea, if there is commercial will to do it. The best starting point, he believes, is Supsa because the Baku-Supsa pipeline ends there. Nevertheless, ships would keep all the Georgian oil terminals in operation and would be faster to put into operation. Khetaguri noted that to handle a pipeline or increased oil volumes by ship, the Odessa-Brody pipeline will have to be reversed to supply Europe, something that has not yet come to pass despite Ukraine's support for the idea. He is pleased, however, that Memoranda of Understanding have been signed among the Azeri, Georgian, Ukraine, Latvian and Polish governments. On the other hand, he observed, there is no agreement yet between Kazakhstan and Azerbaijan. Georgia's interest is to maximize oil transit volumes, Khetaguri said, and Georgia is free and willing to negotiate with anyone to accomplish that. He added that if a new oil pipeline becomes feasible, it would make sense to construct a

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gas pipeline alongside it.

15. (C) The Ambassador raised BP's concerns about the GOG's delay in authorizing the increase in capacity of the BTC pipeline. Khetaguri said that the GOG is no longer linking approval of the BTC pipeline expansion to BP's provision of gas from the ACG field to Azerbaijan. He said that after he and PM Gurgenedze met with BP's Andy Inglis in London (apparently in December), the issue of BTC expansion is now linked to the GOG receiving a good explanation of when the Baku-Supsa pipeline will reopen, who will operate it and how. The additional capacity on BTC is more than the Baku-Supsa pipeline normally transits, he said. Khetaguri's concern is that the Baku-Supsa pipeline might essentially be abandoned as oil that is currently shipped through it by the Western companies will be diverted to BTC. He added that the closure of Baku-Supsa cost the Georgian government \$17 million in transit fees last year. He contends that all necessary work on the pipeline in Georgia is complete, but there is work to be done on the Mtkvari (Kura) river crossing in Azerbaijan. (Note: BP's country manager for Georgia, Hugh McDowell, was unaware of the change of tactics by Khetaguri and the GOG when we called him to ask if he had heard about it from the GOG. On March 7, we talked to Mat Taylor in BP's office who said that BP has provided an update on the Baku-Supsa reopening to Khetaguri, and is waiting to see if the information has satisfied the Ministry. Taylor said that the consortium voted on March 6 in Baku to move forward with the BTC expansion.)

GEORGIAN OFFERS IN TOUGH NEGOTIATIONS  
WITH THE AZERIS  
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16. (C) Khetaguri said that Georgia would like to see the Shah Deniz agreement amended to give Georgia an option to purchase at commercial prices any gas not taken by the Turks or that is produced in excess of quantities foreseen in the existing contract. He said that AIOC had agreed in principal to this in December and were supposed to send a draft contract but

have not yet done so. As for SOCAR gas, Khetaguri said SOCAR has told the GOG it has no gas to deliver until May, when it can begin supplying 3.5 million cm/day, sufficient to cover all Georgia's needs until September. After that, he said, SOCAR will face a deficit and can't say what will be available to Georgia. Khetaguri said that Azerbaijan burned a million tons of mazout in 2006-07, but only 350-400,000 tons in 2007-2008, so it has the option to burn more in 2008-2009. Khetaguri said that he had offered Azerbaijan a five year contract, and was willing to pay \$150-160 per tcm of gas, an amount calculated based on the cost of mazout that Azerbaijan would have to burn to free up gas for Georgia (as much as 850 million cm, according to Khetaguri). The Azeris are increasing domestic production and storage capacity. After mid-2009, when sufficient gas is available that Azerbaijan can supply Georgia gas without burning mazout, Georgia would pay a commercial price for its supplies, Khetaguri said. The only response from the Azeris, according to Khetaguri, is that a fair price for gas is \$160-180 -- if gas were available, which the Azeris say it is not. Khetaguri remains disappointed by BP's unwillingness to sell more gas that it usually reinjects into the ACG oil field. He said that Georgia would even be willing to buy mazout for Azerbaijan and take gas in return. Also, an offer to swap 100 megawatts of Georgian electricity for gas was refused by the Azeris, ostensibly because the power lines into Azerbaijan cannot handle the load. Khetaguri disputes that.

17. (C) Khetaguri estimates Georgia's current yearly gas needs at 1.85 billion cubic meters. 1.3 bcma is needed for residences and power generation, he said. As of October 2007, he said, all new customers have no regulated tariff and must pay commercial prices for gas from whatever source they can find. Gazprom is now charging \$280 per thousand cubic meters, he said. This year, Georgia is entitled to 300 million cm from Shah Deniz, 200 million for transit from Gazprom and has an option for 300 million more at a cheap price from Shah Deniz. This leaves a deficit of 500 million cm that must be procured at commercial prices. In 2009, there will be an additional 100 million available from Shah Deniz and the deficit will be only 400 million cm. The GOG got the population through the current winter by subsidizing gas prices, via a credit to Georgia Oil and Gas Corporation, which markets it to customers in Georgia. GOGC's profits will be accordingly reduced as it has to pay back the credit, he said.

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#### NOT SO FAST ON SELLING GEORGIAN RAILWAYS

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18. (C) The Ambassador asked Khetaguri about his opinion of plans to sell Georgian Railways, which transports millions of barrels of Azeri oil to the Batumi Oil Terminal and soon to the Kulevi terminal. He said that by seeking expressions of interest in purchasing the railroad, the government is trying to get a realistic idea of what the value of the railroad is. Current plans call for selling just a 10 percent interest to a strategic partner, with a sale of the rest of the railroad to come sometime in the future.

#### INCREASING HYDROPOWER

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19. (C) Khetaguri said the government now has a feasibility study in hand, funded by a USTDA grant, for a 220 kilovolt transmission line to Turkey. Construction of the line is expected to begin in early 2009. He said that originally, an upcoming issue of Eurobonds by the GOG was intended to fund this project and the much-needed gas storage project. However, the German development bank, KfW, has offered even more attractive terms than the Eurobond and the GOG will use that money to fund construction of the transmission line. Once the line is up and running, he said, the government will sell the company that runs it. The proceeds will be used to

make further energy infrastructure upgrades around Georgia. Additionally, the government is planning to rapidly increase hydroelectric capacity. It has an MOU with Turkish investors to build seven new plants in Adjara which will add 119 megawatts of capacity by 2015. Kuwaiti investors have backed out from construction of a new plant on the Rioni river, but the government is studying the project and intends to re-open it for tenders. The project for a large dam and power plant at Khudoni is proceeding with World Bank assistance and is expected to be completed in 2012 or 2013. Khetaguri said that past plans had not properly accounted for efficiencies created at power plants downstream from Khudoni, and the entire project will actually produce 1 billion kilowatt hours more than previously calculated, making it more financially viable than previously believed.

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